CEE State Trading: Questions Lurk Behind Notifications

Four of the CEEs—Poland, Slovenia, Slovakia, and the Czech Republic—have notified the WTO of the existence of state trading enterprises (STEs). However, questions persist despite these notifications. There are state-owned enterprises in other CEEs that meet the WTO definition of an STE but that have not been notified. For STEs that have been notified, a lack of good data makes it difficult to evaluate the full impact of state trading. [Nancy Cochrane]

Since the conclusion of the Uruguay Round, there has been a growing interest in the issue of state trading. Regarded as one piece of unfinished business, state trading is expected to be an issue for the next round. There are several reasons for the interest in this issue. First, the definition set forth in the Uruguay Round is vague—there is considerable ongoing debate, for example, as to whether certain countries fit the definition of a state trader. Second, there is some concern that state trading may be used to circumvent the strict limits on import tariffs and export subsidies laid out in the WTO Agreement. Third, since the signing of the WTO Agreement, several countries have set up new state trading enterprises (STEs) to implement the tariff rate quotas. Finally, Russia and China are now negotiating the terms of their accession, and both countries make extensive use of STEs to regulate their foreign trade.

Most of the U.S. interest in state trading focuses on the larger players in international markets, such as the Canadian and Australian Wheat Boards and the Japan Food Agency. But the Central and Eastern European (CEE) countries are also of interest. Since the beginning of the transition, many of them have established regulatory agencies that carry out intervention purchasing and administer export subsidies. In most cases these agencies have been notified as state trading enterprises to the WTO. In other CEEs the state-owned foreign trade organizations (FTOs), which had a monopoly before the transition, have retained much of their influence over imports and exports. While no one of the CEEs has a great influence on world markets, taken together, they represent a large potential market for some commodities and significant potential competition in others. And because of still underdeveloped markets and information systems, the STEs in the CEEs have considerable influence on domestic and foreign markets that is still difficult to measure.

What Is State Trading?

STEs first were recognized as legal entities under the 1947 General Agreement on Tariffs and Trade (GATT). The 1947 GATT required that STEs adhere to the general principles of non-discriminatory treatment and, recognizing that the operations of STEs might impede trade, allowed for negotiation between GATT members to reduce such impediments. To clarify the types of enterprises that can be defined as STEs, an official definition of state trading enterprises was adopted in the Uruguay Round:

> *Governmental and nongovernmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.*

Why Are STEs of Interest?

The exclusive or special privileges conferred on an STE give it the power to greatly influence the quantity and price of exports and imports. Its activities can result in significant import barriers or de facto export subsidies. The actions of an STE cannot create non-tariff barriers to imports, and they cannot result in export subsidies that exceed the WTO limit. A lack of transparency in many STEs' pricing practices often makes it difficult to determine if they are within GATT limits

Several types of STEs have been identified. The most common in agriculture are statutory marketing boards, which are government-sanctioned monopolies with exclusive control over functions such as purchasing domestic production, conducting foreign trade, or setting producer or consumer prices. Similar to those are regulatory marketing boards, which, while maintaining control over imports and exports, do not directly engage in foreign trade but contract with private trading companies to carry out the actual operations. Another type is the foreign trade organization, which used to be typical of the centrally planned economies. The most commonly stated objectives of STEs are price stabilization, export promotion, income support for producers, and food security. The products most commonly regulated by these organizations are grains (particularly wheat) and dairy products.

Previous work done at ERS developed a classification scheme that is helpful in understanding the impact of STEs on imports or exports, as well as their potential for circumventing WTO commitments.[3] The key distinguishing characteristics that have been defined are:

- Trade balance: Is the STE an import or export-oriented STE?
- Market regime: To what extent does the STE exert control over a) exports or imports, (b) domestic marketing, c) commodity procurement and d) processing?
- Policy regime: Which policy tools (export subsidies, tariff rate quotas, supply controls, price support, marketing of imported goods, etc.) are available to the STE.
- Ownership: Government, producer group, or otherwise;
- Products regulated.

Export-oriented STEs can subvert WTO limits on export subsidies through price pooling and excessively discriminatory pricing. An STE that engages in price pooling typically pays producers a percentage (perhaps 80 percent) of the expected final price on delivery. The final price paid to producers is a blended price based on net revenue from all sales in domestic and international markets. Price pooling can make it easier for an STE to engage in price discrimination, charging high prices in domestic markets while subsidizing exports.

STEs also have the advantage of lower costs in the form of government-backed credit and less risk. Depending on the extent of its monopoly on purchasing, an export STE has an assured supply of raw product. Even if it is not a true monopsony, the availability of low cost-credit may give it an advantage over other purchasers. It can make forward sales at set prices without worrying about supply availability at time of delivery. It thus faces a lower credit risk than private organizations. It also has greater freedom to make export sales commitments and has an advantage in reaching long term agreements with importing countries.

Import STEs influence domestic production and pricing as well as imports. Some import STEs are the sole importers of certain products; others influence imports through contracting arrangements or licensing. Some establish markups for commodities imported under TRQs, control processing and distribution of imported goods, and conduct quality and safety inspections. Importing STEs can use their power to block imports even when a market exists in the country, raise the price of imported products by limiting distribution (keeping imported products out of certain markets) or discriminate among suppliers for political reasons. If a country allows an STEs operations to provide import protection at levels above the bound tariff rate, it can be considered to be in violation of its GATT commitments.

[3]Ackerman, Karen, Praveen Dixit and Mark Simone, "State Trading Enterprises: Their Role in World Markets," *Agricultural Outlook*, June 1997/AO-241, Economic Research Service, United States Department of Agriculture.

It is by no means the case that all STEs are violating WTO rules in these ways. The problem is that without good information on prices paid for imports, markups for sales in domestic markets, and average producer prices compared to average export prices, it is impossible to judge whether the rules are being circumvented.

Do the CEEs Engage in State Trading?

According to the above definition of state trading, the two criteria on which to assess the existence of state trading are:

1) The organization has a special right or privilege.

2) In the exercise of these rights, the organization influences the level or direction of trade through its trading activities.

There is hardly any question that during the Communist period all the CEEs engaged in state trading. Virtually all foreign trade was carried out by state-owned foreign trade organizations (FTO), which generally had a monopoly over trade in given commodities. Imports and exports were controlled by the central government through extensive use of non-tariff barriers that were often non-transparent.

After 1989, the monopoly status of the FTOs was abolished, as were most quantitative restrictions on trade. All firms, private and state were given the right to engage in foreign trade, and private companies now conduct an increasing share of imports and exports. Many of the old FTOs still exist, but most no longer have a monopoly and many are in various stages of privatization.

While none of the CEE governments control foreign trade to the extent they did before 1989, state trading by the above definition does exist in most of the CEEs. In some cases the old FTOs and other state-owned enterprises retain much of their former influence, even though they are no longer monopolies. Often these state enterprises receive benefits from the state that are not available to other firms. In other cases CEE governments have created regulatory agencies responsible for administering the government intervention programs. These agencies in most cases meet the WTO criteria for state trading and have been notified (identified to the WTO) as state trading enterprises. While there is no evidence that they have been used to circumvent WTO commitments, these agencies have significantly affected domestic and international trade in the CEEs and could be used in this way. The problem is that inadequate data and market information make it difficult to determine the full impact of these state trading activities on imports and exports.

The Regulatory Agencies Notified to WTO

By the two criteria, the various state intervention agencies that have been established in Poland, the Czech Republic, Slovakia, and Slovenia since the early 1990s qualify as STEs. These agencies include the Agricultural Market

Agency (AMA) in Poland, the State Funds for Market Regulation in the Czech and Slovak Republics, and the Agency for Commodity Reserves in Slovenia (table 4). These were created in response to the drastic decline in producer income that occurred immediately following the beginning of the transition. Their principal role is to establish and support minimum prices for key commodities and stabilize prices of other commodities through intervention purchasing. However, to support minimum prices and avoid buildup of excessive stocks, they are also involved in subsidized exports. They are also responsible for allocation of domestic quotas to commercial firms for intervention purchases and export subsidies.

These agencies are involved in both imports and exports, except for Slovenia's Agency for Commodity Reserves, which only deals with imports. All are government owned. Through their activities they can influence all four market activities identified in Ackerman et al. (imports and exports, domestic marketing, procurement, and processing). But they do not have 100 percent control over any of these activities. The instruments used are guaranteed minimum prices, intervention purchasing, and export subsidies.

These agencies do not engage directly in foreign trade but contract with commercial trading companies to undertake imports or exports on their behalf. None of them can be said to have an absolute monopoly on foreign trade, and none of them engage in price pooling. But through their intervention purchasing, they are heavily involved in domestic procurement. The Polish AMA is also involved in processing. All these agencies by their very nature enjoy privileges not granted to other trading entities and to that extent conform to the definition of state trading. The privileges are for the most part in the form of direct government funding and government backed credit. Because of these special privileges, the governments of Poland, Slovakia, and the Czech Republic have notified the WTO of the existence of state trading in their countries.

Hungary maintains it has no state trading. Decisions on agricultural market support are made and implemented by the Agricultural Market Regime, which is an inter-Ministerial committee with representatives from the Agricultural, Foreign Trade, and Finance Ministries. This committee makes decision on levels of producer support and subsidized exports. The actual operations are carried out by commercial companies selected through tenders. The Hungarians maintain that this office is not a state trading enterprise because it is a government committee that does not engage in commercial activities.

Poland's AMA was first established in 1991. Its primary function at that time was to stabilize commodity markets through intervention purchasing—buying up stocks when prices were falling and releasing them back onto the market when supplies were tight. Its role expanded in 1992 when it was given authority to set guaranteed minimum prices for wheat, rye, and dairy products, which it supported through intervention purchasing. Since 1992 its role has expanded still further, and it is now involved in the management of the

Table 4--CEE State Trading Agencies as Notified to WTO

Country	STE	Ownership	Commodities	Policy instruments
Poland	Agricultural Market Agency	Government	Wheat Rye Dairy products Pork Sugar Wool	o Sets minimum prices o Conducts intervention purchasing o Provides credit guarantees to authorized warehouse purchasing wheat at minimum price o Provides 45 percent advance payment to producers who keep their wheat in storage o Authorizes subsidized exports o Buys and sells for strategic reserve
Czech Republic	State Fund for Market Regulation	Government	Food wheat Butter Skim milk powder Cheese Malt	o Establishes minimum prices o Authorizes intervention purchasing on its behalf through tenders o Administers export subsidies
Slovakia	State Fund for Market Regulation	Government	Food wheat Live cattle, Beef, Pork, Dairy products, Poultry and eggs, Sugar Potatoes, Starch	o Establishes minimum prices o Authorizes intervention purchasing on its behalf through tenders o Administers export subsidies
Slovenia	Agency for Commodity Reserves	Government	Wheat Sugar	o Establishes minimum price o Conducts intervention purchasing o Authorizes import of duty free quota for wheat o Subsidizes sales to flour mills

strategic reserve and in providing preferential credit to grain producers and warehouses.

Currently, the AMA intervenes in grain markets in the following ways:

- Direct intervention purchasing, using funds provided by the state budget. This accounted for 31 percent of all intervention purchases in 1995/96.
- Procurement through a network of authorized warehouses. The warehouse agrees to purchase wheat at the intervention price and in return AMA provides guarantees for preferential credit to the warehouses. After 3 months, period the AMA will purchase the grain at the intervention price plus storage, interest and handling. This accounted for 51 percent of all intervention purchases in 1995/96.
- Advance payment to selected producers. Wheat producers who are willing to store at least 100 kilograms of wheat can receive an advance payment of 45 percent of the intervention price. The producer is obliged to leave the grain in storage for 3 months. At the end of that period, the producer can either repay the advance plus interest in cash, or forfeit 45 percent of the grain to the Agency and take back the remaining 55 percent, which can either be used on farm or sold on the open market. This accounted for 18 percent of all intervention purchases in 1995/96.

The AMA also sets and administers minimum prices for dairy products and carries out intervention purchasing of pork and sugar. It also periodically engages in the import and export of these commodities; some of the exports have been subsidized. It does not directly engage in trade, but contracts with commercial companies to carry out the transactions on its behalf. In the early years of its existence, the AMA had a substantial share in the foreign trade of certain commodities. In recent years its share in foreign trade has been lower, but it still has the authority to carry out foreign trade directly.

The AMA also maintains the strategic reserves and periodically buys into or sells from that reserve. Not only is the size of the reserve kept secret, but the AMA also does not divulge the size of purchases or sales from the reserve.

The Czech and Slovak State Funds for Market Regulation (SFMR) were created on similar objectives as the AMA—to stabilize prices and maintain producer income. Both operate on similar principles. They regulate the market for key commodities through intervention purchasing or subsidized exports. Neither engages directly in either domestic purchasing or foreign trade, but contract with commercial companies to act on its behalf. These companies are selected through tenders. Import licenses, with the exception of imports under TRQs, are granted automatically. However, the Funds have restricted export licenses (particularly for wheat) in the interest of keeping sufficient supplies within the country. Licenses for imports under TRQs are issued by the Czech customs authority on a first-come, first-served basis. The Import Licensing Division of the Slovak Ministry of Economy on behalf of the Ministry of Agriculture allocates imports under the TRQs.

The main difference between the two countries is the number of commodities regulated and the extent of intervention. The Czech Republic only regulates food wheat and dairy products: wheat through intervention purchasing and dairy products through subsidized exports. Slovakia intervenes in a broader range of products, including grain, live cattle and beef, pork, dairy products, poultry and eggs, sugar, potatoes, and starch.

Slovenia. The Slovenian Agency for Commodity Reserves is a particularly interesting case, since it appears to have a far more pervasive influence on trade of wheat and sugar than any of the agencies described above. The agency is the only authorized purchaser of wheat, which it buys at a very high minimum price set by the government. It also contracts with commercial firms for the import of a duty free quota of wheat. The Agency then sells the wheat to the flour mills at a price that is between the high internal price and the import price. Other firms are free to import, but must pay the published tariff rate. Intervention in the sugar market is quite similar, except that purchasing is carried out by a commercial company that has a monopoly on the Slovenian market.

State Trading in Romania and Bulgaria. State trading takes a different form in Romania and Bulgaria. Neither has an agency analogous to the AMA in Poland, and both governments have notified the WTO that they have no state trading enterprises. However, the purchasing and foreign trade of bulk commodities in both countries continues to be heavily dominated by state-owned companies, and the governments have played a major role in manipulating domestic prices and levels of foreign trade. But these activities have not generated much concern among exporting countries because their primary impact has been to restrict exports rather than to undercut export markets or impose hidden import barriers. Moreover, both countries are in a state of accelerated transition. They are under pressure from international lending institutions to speed up the privatization process, allow greater competition, and to allow the non-viable state enterprises to be shut down.

In **Romania** the former Romcereal had a virtual monopsony on the procurement of wheat. Almost all marketed wheat was purchased by Romcereal at prices that were barely half the world level. Romcereal did not engage directly in foreign trade, but controlled most storage and the supply and prices charged to potential exporters. In June 1995, Romcereal was dismantled. Part of it was reorganized as the National Agency for Agricultural Products (ANPA); the remainder was split into several commercial companies, called Comcereal. These companies are eventually to be privatized, but at the moment most are majority state-owned. Furthermore, the functions of ANPA are rather broadly defined, to include purchasing, storage, and reserve management. In the year since the reorganization, virtually all the Comcereal companies remain majority state owned, and there does not appear to have been any increase in competition among purchasers of wheat.

More seriously, all the grain silos at Romania's largest port of Constanta are owned by a majority state owned company, Agroexport. The director of this company has considerable power to control the flow of exports out of the country, thus affecting the domestic market price.

This situation could have led to low-priced exports that undercut the world market, especially in 1995/96, when Romania had a wheat surplus of close to 2 million tons. But because of government policies intended to maintain stable supplies of low-priced bread, combined with bottlenecks in the local infrastructure, the Romanians were unable to take advantage of their surplus. The capacity of the port of Constanta was too low, and transportation was inadequate to move the grain to the port. In 1996/97 there was no exportable surplus, the result of a drastic decline in area planted and a very harsh winter.

There is no single agency in **Bulgaria** that can clearly be identified as a state trader. But much of the purchasing, processing, and foreign trade, particularly of grains, continues to be carried out by companies that are still majority state-owned. These companies receive benefits from the state that are not available to private companies. For example, after the 1997 harvest, the Agricultural Minister made available about 260 billion leva (US$146 million) for low interest loans to a select group of mills to enable them to purchase the 1.1 million tons of wheat that officials estimated was necessary for the nation's food supply. Ministry of Agriculture officials have stated that both state and private mills could apply for this credit. However, it has happened that all the credit was granted to enterprises in which state ownership was over 50 percent. These included 27 state mills. The largest, Zarneni Chrani, obtained the highest purchasing quota, 843,000 tons, which makes it nearly a monopoly on the grain market. Bulgaria has notified the WTO that it has no state trading enterprises, but these state mills, particularly Zarneni Chrani, appear to enjoy some of the benefits of state traders.

But both countries are on the brink of major changes. Romania elected its first non-Communist government last year, and the Bulgarian elections held last spring brought an opposition victory. Both governments are now committed to speeding up the market reform process, moving much more rapidly to privatize ailing state-owned firms and to get the government out of the business of controlling domestic prices. The Romanians have pledged to privatize all the Comcereal companies, and the Bulgarians intend to split up Zarneni Chrani and privatize the new companies.

Issues for the Next Round

The key question for the next round of trade negotiations is not so much the existence of state trading in Central and Eastern Europe, but whether state trading is used by these governments to circumvent the commitments made to the WTO on import tariffs and export subsidies. On the surface it would appear that these state trading institutions are not used in this way. While high, tariffs imposed by the CEEs do not exceed the bound levels. As for export subsidies, only Hungary has exceeded its commitment, and this cannot be said to be due to state trading. Calculations by OECD indicate that aggregate Producer Subsidy Equivalents (PSEs) throughout the CEEs are quite low relative to Western Europe.[4]

Yet, there are a number of reasons why this will be an issue for the next round. For one thing, the definition of state trading is vague, allowing some governments to notify the WTO that they have no state trading, when in fact they do have institutions that meet those criteria. Another major problem is that these institutions in many cases affect levels of imports and exports in ways that are not easily measured. Published tariff rates and PSE calculations based on price gaps do not tell the whole story.

The definition problem. Hungary, Romania, and Bulgaria have all notified the WTO that they do not have state trading enterprises. The Hungarians maintain that the Market Regime Office is a government agency of representatives from three different Ministries and is not an enterprise. But it performs the same functions as the SFMR in Slovakia and the Czech Republic. At the same time the Hungarian Holstein Breeders Association has been granted the exclusive right to import bull semen and there are charges that it regulates the flow of imports by charging a higher price for imported product than for domestic. But the Hungarians argue that this can't be a state trader because it is not a state-owned organization. The Romanians and Bulgarians maintain that enterprises such as Zarneni Chrani or Agroexport are commercial companies that enjoy exactly the same rights as any other commercial company. Yet these are state-owned companies that receive special privileges (such as low interest credit) which are not equally available to all.

Impact on trade levels. The intervention agencies in the CEEs have considerable influence over the domestic market for key commodities, particularly grains. These STEs do not

[4]The producer subsidy equivalent, or PSE, is an aggregate measure of the value of all transfers to producers of a given commodity. It has been defined by ERS as "the level of subsidy that would be necessary to compensate producers (in terms of income) for the removal of government programs affecting that commodity" (*Government Intervention in Agriculture, Measurement, Evaluation, and Implications for Trade Negotiations,* FAER-229, U.S. Dept. Agr., Econ. Res. Serv., 1987).

have a monopoly on either domestic or foreign trade of the commodities they regulate. However, the funds available to them through the state budget and other special privileges they receive gives them a significant advantage over private traders. This market power gives them the potential to violate the principles of WTO, but it is not clear that they have done so. The main problem is a lack of transparency in their operations that makes it difficult to assess the extent to which this may have happened.

One problem is a lack of reliable data. Official Slovenian tariff rates, for example, are right at the bound levels, but it is clear that the Agency for Commodity Reserves has considerable power to regulate imports. But the price data needed to calculate the true tariff equivalent of its activities are not available, and Slovenian economists complain that the activities of the Agency are not at all transparent. Likewise, charges that the Hungarian Holstein Breeders Association engages in price discrimination are only hearsay. The data needed to support or refute such charges are not available.

According to OECD calculations of PSEs, the impact of the Czech and Slovak Funds on wheat prices has been minimal (PSEs are negative), even though the volume of wheat exports subsidized by the Funds has been substantial in some years (table 5). The Funds' influence on dairy markets is much more evident, however. In most years, for example, the Slovak Fund has accounted for two-thirds or more of that country's exports of cheese, skim milk powder, and butter, and PSEs calculated by OECD for these commodities are relatively high (39 percent for the Czech Republic, 49 percent in Slovakia).

In general, the SFMRs have a considerable role in determining the quantities that are imported or exported. They have been the agencies that imposed export bans (especially of grains) when there were shortfalls. However, export bans, while they distort the domestic market, are not of much concern to major exporting nations, since if anything they create more opportunities for export. The agencies' influence on import levels is less direct, since WTO prohibits quantitative restrictions on imports. But their regulation of the domestic market does affect the level of imports.

Table 5--Subsidized Exports of State-traded Commodities: The Czech Republic, Poland and the Slovak Republic, 1995

Country/Commodity	Czech Republic	Poland	Slovak Republic
		1,000 tons	
Beef	22.8	0.7	0.2
Cereals	1,274.4	0.0	0.0
Malt	205.4	0.0	94.3
Milk powder	70.3	0.0	7.1
Other dairy products	80.1	0.0	6.5
Pork	1.7	0.0	0.0
Poultry and eggs	12.8	0.0	0.1
Starch	3.4	0.0	0.0
Sugar, sugar confectionery	95.8	0.0	0.2

Source: Countries' notifications to the World Trade Organization Committee on Agriculture.

The Polish AMA engages in foreign trade to a lesser extent than the SFMRs. However, it is authorized to engage in foreign trade and will export stocks that cannot be sold on the domestic market, often at a loss. But it is not clear whether these exports are included in Poland's official reports of export subsidies. For example, early in 1997 the AMA purchased 109,000 tons of pork. Of that, 69,000 tons were released onto the domestic market later in the year and an undisclosed amount was exported, primarily to the Former Soviet Union. The AMA did not export directly, but contracted with a number of firms to act on its behalf. An official of the AMA said that most of this pork was exported at a loss, but maintained that this did not constitute an export subsidy because no payment was made to the exporting companies. It is difficult to determine the extent to which these AMA pork exports were subsidized. The volume of AMA exports is known, but it is more difficult to determine the prices at which the pork was exported.

The full impact of the AMA on Poland's domestic and international trade is further obscured by the fact that the AMA is responsible for both intervention purchasing and buying and selling for the strategic reserve. This dual responsibility creates considerable potential for conflict of interest. These are two separate functions, and both activities can affect the market, but the transactions on behalf of the strategic reserve are a state secret.

Finally, the fact that levels of market price support calculated by OECD are generally low can be misleading. OECD calculates market price support based on the gap between domestic prices and a world reference price. One obvious problem is the choice of a reference price. But leaving that issue aside, there is a more fundamental problem with this method. In a transition economy there are two basic factors that contribute to a price gap. One is the active intervention measures taken by governments—price supports, export subsidies, tariffs, etc. But another factor is that most of the countries still suffer from serious bottlenecks in the processing and distribution sector, and the effect of these bottlenecks is to depress producer prices. Without any overt government support, these institutional rigidities would result in prices well below the world level. Thus it can easily be the case that the impact of very high overt government support can be hidden in a calculation of market price support based on a price gap.

The influence of the STEs could wane as private markets become better developed, although arguably, their very existence is slowing down the development of those markets. But ultimately, the life of these agencies in their current form is constrained by these countries' impending accession to the European Union. With EU membership, these agencies will not be able to operate in the way they now do, but will likely become purchasing agents for the European Commission.